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Supreme Court of the United States

October Term, 1978

No. 78-182

O. E. SERWOLD and HELEN SERWOLD, his wife,
Defendants-Petitioners,

v.

KENNETH N. NELSON,
Plaintiff-Respondent.

BRIEF IN OPPOSITION

TO

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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WHY THE CAUSE SHOULD NOT BE REVIEWED

The Ninth Circuit Court of Appeals' Opinion in this cause should not be reviewed by this court because:

1. The Opinion is correct in all of its respects, save for its agreement with the District

Court that Coie's affirmative misrepresentations were not material, a conclusion favorable to defendants-petitioners;

2. The district judge did not, as petitioners claim, find that defendants "acted without 'scienter,'" as properly defined, and that their conduct was not "knowing," nor did he find but a mere "technical violation" of Rule 10b-5. He categorically defined "scienter" as "deliberate and cold-blooded" concealment of material facts (R. 314, 366). He refused to find defendants' omissions "occurred knowingly in the 'scienter' sense," i.e. knowingly in the sense of being "deliberate and cold-

blooded." He spoke of a "lack of deliberate and wilful fraud in this case" (R. 352) and of his belief that defendants did not "wilfully and deliberately set out to conceal information" (R. 351). Unconcerned with scienter, except for purposes of rejecting restitution ("constructive trust"), because the "fraud" was not "relatively severe" (R. 351), the district judge did not make any finding of ultimate fact concerning any degree of culpability less stringent than intent to deceive. Recognizing that knowing misrepresentations or omissions, irrespective of intent, as well as recklessness, suffice for "scienter," the Ninth Circuit prop-

erly inferred from the circumstantial facts found by the District Court that defendants' conduct at least fell within such lesser degrees of culpability;

3. The district judge had no "equitable discretion" to adopt an erroneous measure of damages and apply thereto a hodgepodge of erroneous notions enumerated on page 3 of the petition;

4. The decision is not upon a unique question of federal law, but is in accord with applicable decisions of this Court and is not in conflict with any decision of another court of appeals on the same or similar matter; and

5. The federal issues are rendered moot by the District

Court's finding of violation of the Washington counterpart to Securities Exchange Commission Rule 10b-5, RCW 21.20.010 (1959), and by the Washington legislature's retrospective amendment of the Civil Liabilities section of the Washington Securities Act, wo-wit: RCW 21.20.430(2) [1977] creating strict civil liability for "violation" of RCW 21.20.010, and defining "damages" for purchaser fraud as

> the value of the security when the buyer disposed of it, and any income received on the security, less the consideration received for the security, plus interest at eight percent per annum from the date of disposition, costs, and reasonable attorneys' fees,

precisely, except for addition of reasonable attorneys' fees, the correct federal measure.

COUNTER-STATEMENT OF THE CASE

A Case of Agreed Facts

Almost all of the essential facts of the case are admitted and are set forth separately, and are enumerated, in the Pretrial Order (R. 268, 269-281). There exists no conflicting or ambiguous testimony. The entirety of the fraudulent securities transaction, in its every aspect, was carried on exclusively by use of the United States mails directly between defendants' Seattle attorney, J. Paul Coie (Coie), and plaintiff's Rhinelander, Wisconsin, attorney, Earl A. Korth (Korth), except the initial communication, Ex. "A" (R. 24), was mailed from Korth to Poulsbo Rural Telephone Association (PRTA). (R. 270-71, 360-61.)

On September 26, 1975, 507 days after the allotted one-day trial to the court, the District Court judge, prompted by plaintiff having filed in the

Court of Appeals (No. 75-2850) his Petition For Writ of Mandamus requesting the district judge be required to forthwith enter findings of fact, conclusions of law and judgment, signed Findings and Conclusions, "finding" twenty-five of forty-five admitted facts, fashioning one of his own (FF 27, R. 365), and adopting three proposed by defendants (FF 26, 28 and 29, R. 365-6).

Background

Like Chinese boxes, one within another, the securities fraud was within an older and more extensive scheme of corporate mismanagement. In the beginning, about the year 1956, defendant O. E. Serwold (Serwold) discovered that insurance company financing was finally available to effect modernization of PRTA's extremely antiquated telephone system (Tr. 0030, 0032-33). Defendants, Rudie and Evelyn Iversen, W. H. Gee and

Coie (the control group) decided to attempt to acquire in Serwold's name (Tr. 0047) all (Ex. "NN") of PRTA's outstanding stock (Tr. 0029-30). Their plan was to at least acquire control, modernize the telephone system, convert the company to a marketable enterprise and then sell it to an independent company (FF 27, R. 365, Tr. 0049). The control group members entered into a continuing agreement by which all of the PRTA stock owned of record, or which might in the future be acquired by any of them, was beneficially owned approximately 30% by the Serwolds, 30% by the Iversens, 30% by Gee and 10% by Coie [AF (Admitted Fact, Pretrial Order) 2.23, R. 274-5, partly adopted as FF 23, R. 363]. The agreement was a carefully-kept secret. It was never disclosed to PRTA's 150 shareholders (R. 359) not members of the control group, nor was the same ever reported to the Washington Utilities and

Transportation Commission, and, of course, no disclosure of the existence of the control group or of its plan to sell the company was ever made to Korth or to his clients, the Nelson family (AF 2.23, R. 274-5, c.f. FF 23 and 27, R. 363, 365). By 1959 the secret control group had acquired about 55% of PRTA's outstanding stock, all placed in Serwold's name (Tr. 0030, 0047, cf. Tr. 0011-12, 54% acquired in 1956).

Serwold was made PRTA's $24,000 per year president in 1957 and at all times he and his wife were PRTA directors (FF 8 and 9, R. 359-60; AF 2.8 and 2.9, R. 269). Their son, Roger, was a salaried PRTA employee (AF 2.28, R. 276-7). By 1971 Serwold's and Roger's salaries had progressively increased to $36,000 and $18,000, respectively (Id.). Under these comfortable circumstances, the nurtured facade of Serwold owning a majority of PRTA's stock naturally dis-

couraged any speculation that the seeming family enterprise would ever be sold. Just as naturally, despairing, uninformed stockholders would from time to time sell their shares to Serwold for his fixed price of $8.00 per share (Tr. 0031-37, 0098, Ex. "NN"). Had the existence of the control group and the diverse ownership of the control stock been disclosed, at least sophisticated shareholders might have discerned a probability of sale, judging from the advanced age of the control group members, the fact that only Serwold had a child active in the business, and the realities of estate planning with respect to unmarketed, close corporation stock.

Perjurious denials of the existence of any control group were persistently made in Annual Reports to the Washington Utilities and Transportation Commission. (See, i.e., Ex. 4, Annual Report to

Comn., December 31, 1964, p. 2, Serwold's answers to queries 2 and 3 denying as "not applicable" the existence of any control group, and p. 5, query 2, eliciting the names and addresses of each person having a beneficial interest in defendant's PRTA stock, such query not answered. All such Annual Reports were uniform with respect to such denials and nondisclosure.)[1]

When the control group acquired control of PRTA, they soon, to paraphrase Churchill, "rang down an iron curtain" upon the company's internal affairs. The flow of information to out-

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[1]Serwold also falsely certified, annually, that PRTA had no contract or lease with "any affiliated interest" (i.e., a beneficial owner of 5% or more of PRTA's stock (RCW 80.16.010)) such as W. H. Gee, a member of the secret control group. In 1957, Gee constructed a modern telephone building and leased it to PRTA for a term of twenty years. He purchased the land from fellow-control group members Rudie and Evelyn Iversen. Nondisclosure of Gee's affiliation circumvented obtaining regulatory agency approval of the lease, though a statute declares such a lease invalid in the absence of Commission approval. RCW 80.16.020.

sider stockholders ceased. All outsiders were ousted from management. (Ex. "00", Tr. 0015-18.) PRTA's stockholders were not treated to meetings from February 1959 through 1965 nor, in the years 1960-1970, inclusive, to any PRTA financial statement, newsletter or narrative progress report (AF 2.24, 2.25 and 2.26).

By the time of Coie's 1965 solicitation of the Nelson family's PRTA stock, there was nothing "long range" (cf. FF 27, R. 365) about the control group's plan to sell the company. As was established against defendants on remand in Lanning v. Serwold, et al., 474 F.2d 716 (9th Cir. 1973), before District Court Judge George H. Boldt, USDC WD WASH. No. 9525, on 8/26/74, appeal dismissed 4/1/75, Ct. App. No. 74-3405: ". . . There had been, however, during a period of four years immediately preceding

June, 1970, active soliciations by O. E. Serwold and some responses and inquiries by representatives of independent telephone companies respecting sale or merger of PRTA, . . ." (R. 346-47, 350 (Judge Boldt's FF 32)).

In a third case PRTA's attorney, Conrad Greeen, in June, 1970, advised the District Court: "The fact of the matter is that there have been discussions and negotiations for the past three or four years regarding the attempted sale of this Company (PRTA)" (Ex. "HH"). Serwold testified he didn't know where Green got his information (Tr. 0104-5).

The Fraud

On October 17, 1962, Korth wrote to PRTA advising that he had found in his Estate of Nels Nelson, Deceased, file PRTA's stock certificate No. 305 for 36 shares issued in 1911 to R. Norman (Ex.

"A"; R. 24; AF 2.12, R.270; FF 13, R.360; Korth Dep. p. 7). Korth requested: "(Please) . . . advise me of the status of this stock" (Id.).

Serwold, as PRTA's president, received the letter and delivered it to Coie, who was not PRTA's counsel (Tr. 0055-56), but was Serwold's "personal attorney" (Tr. 0019-20). Indicatively, Serwold did not refer the letter to PRTA's counsel, Niemeier, Green & Root, who officed in Poulsbo (Tr. 0020). Mr. Root was routinely consulted on corporate matters (Tr. 0016, 0030).

On December 11, 1962, writing under the letterhead of his large Seattle law firm, Coie wrote Korth: "Your letter . . . has been referred to us for reply. . . . If you can furnish us satisfactory evidence of present ownership, we then may be in a position to offer $5.00 per share" (Exs. "B", "B-1"). Though soliciting an insider purchase, Coie felt no obligation of disclosure (Tr. 0057). His explanation for offering such a low price, was "risk of clouded title" (Tr. 0057), yet his offer was expressly conditioned upon Korth furnishing "satisfactory evidence of present ownership" (Exs. "B", "B-1").

Korth, assuming Coie represented PRTA (Korth Dep., p. 11), wrote to Coie on January 22, 1963, showing ownership in the Nelson estate and inquiring whether "any dividends . . . are accrued" (Ex. "C"). There was no response for 27 months, during which time the Nelson estate was closed (Tr. 0078, Ex. "N"), the administrator retaining the PRTA certificate in his safety deposit box (Tr. 0078) "as a souvenir" (Tr. 0081).

The Nelson family was advised by Korth that there wasn't "enough value in the stock to cover (attorneys') fees"

for obtaining registration of transfer of the stock from R. Norman, who was deceased (Tr. 0077-78). Neither plaintiff nor his brother had ever bought or sold stocks or bonds (Tr. 0074-75).

Abruptly, on April 15, 1965, Coie wrote Korth:

> . . . If you will give us an affidavit (of ownership) and surrender Certificate #305 for 36 shares of (PRTA), the enclosed check of O. E. Serwold . . . in the sum of $180.00 may be cashed.
>
> There have been no dividends ever declared since the formation of this company, and none can be anticipated for years because of mortgage commitments required to finance capital improvements. This is a regulated utility and there has never been a surplus from which dividends could have been declared.

(Ex. "D".) The drawer of the check (Serwold) was never identified other than by his initials and surname. The letter (Ex. "D") indicated to Korth that PRTA was probably in "quite precarious" financial condition. (Korth Dep., p.

49.) Korth assumed $180 represented the fair market value of the 36 shares (Korth Dep., p. 21) and so advised Coie, as well as plaintiff's brother, Herbert Nilsson (Nelson), the administrator (Ex. "E", note "cc: Mr. J. Paul Coie"; see AF 2.12, R. 270; FF 13, R. 360-61). Coie chose to remain silent. Nilsson wrote to his cousin, Wilma Lowry of Seattle, who was related by marriage to R. (Richard) Norman, requesting she learn what she could about PRTA (Ex. "Y", Tr. 0067-68). She responded but was unable to give Nilsson any information (Tr. 68).

On July 9, 1965, Korth, then age 68 (Korth Dep., p. 3), and whose total fees in the matter were $35 (Ex. "K"), wrote to Coie inquiring "whether or not Mr. Serwold would be willing to pay $250 for the stock" (Ex. "F"). The requested price increase was inspired by Korth's

concept of "horse trading" (Tr. 0080). Instinctively, Coie knew Korth wanted "to get a little money for his services" (Tr. 0057). Coie promptly accepted, forwarding another Serwold check for the additional $70 (Ex. "FF-1").

After some delays of which Korth kept Coie apprised (Exs. "G" & "GG-1), Korth on September 16, 1965, mailed to Coie PRTA's stock certificate No. 305 (Ex. "J") and Nilsson's affidavit of heirship (Ex. "I") tracing ownership of the certificate to the Nelson estate. The certificate was endorsed to "O. E. Serwold" by "Herbert Nilsson, Administrator WWA of the estate of Nels Nelson", and by agreement was "dated back to May 1, 1963, when Nilsson was Administrator" (Ex. "J"; Agreement: Exs. "F", "FF-1" and "H").

On September 20, 1965, Coie wrote to defendant: "At long last I think we

have acquired Norman's shares. . ." (Ex. "M", emphasis supplied). Serwold effected registration of transfer of the certificate to himself as a purchaser for value and did not advise PRTA of any fact which might have impaired the validity of the assignment or transfer to him (AF 2.39, R. 280).

The Affirmative Misrepresentations

As found by the District Court, Coie's initial letter (Ex. "B") suggested the value of the stock was only $5.00 per share.

> He (Korth) would not be likely to be making extensive inquiries concerning 36 shares of an undistinguished rural telephone company half way across the country. This is particularly true where the original correspondence suggested a value of only $5.00 a share. . . . (DC Opinion, R. 309, 312, expressly adopted as a finding of fact, FF p. 2, R. 358.)

At the time of Coie's letter (Ex. "B"), the book value per share was $37.20 (AF

2.32, R. 278)[2], and the stock had earned for the past year $3.43 per share (Ibid). Earnings were to almost double in the next year, 1963 (Id.).

When Coie foisted Serwold's unsolicited purchase-money check upon Korth, he advised: ". . . there has never been a surplus from which dividends could have been declared." (Ex. "D".) Both the statement and its implication that the company had never been profitable were false. On June 30, 1956, more than three years before imposition of

[2]The "Book Value Per Share" figures are inadvertently stated $1 less than actual, the mistake arising from failure of counsel to add to "Retained Earnings & Surplus" the company's outstanding capital stock, $7,123, being 7,123 shares outstanding times $1 per share each, thereby understating Stockholders' Equity by $1 per share. For example, "Book Value Per Share" on December 31, 1962, is stated at $36.20 instead of $37.20. Cf. R. 49.

the contractual dividend restriction (FF 21, R. 362), PRTA had "unappropriated earned surplus" of $98,924.55 (Ex. "SS"; see Motion to Reopen Hearing Solely To Permit Admission Of Exhibit, R. 265-7; motion granted Tr. 0130). The entire sum was available for declaration of dividends and remained so until October 21, 1959, when dividends were voluntarily restricted by a covenant contained in a mortgage of that date (FF 21, R.362). The District Court did not find Coie's statement to be true, but only that it was not a material misrepresentation (DC Opinion, p. 1, R. 309, FF 26, R. 365).

The sway of the contractual "dividend restriction" (FF 21, R. 362) contained in the mortgage was more contrived than real. PRTA easily met the minimum capital and surplus requirement as well as the mortgage-debt-to-plant ratio

(Ex. "T"). Only its current ratio, as reported at year-end, was deficient. This was because a large long-term bank debt in the form of a ninety-day bank loan continuously rolled over, was presented as a current liability under "Accounts Payable" (Tr. 0127). Also, PRTA was not extravagant in statement presentation of its year-end accounts receivable. Exhibit "T" peculiarly shows such accounts ("Due from customers and agents") at a mere 1/40th of annual "Operating Revenues", or only a small fraction of an average month's revenue. Apparently, we are to believe Poulsbo's citizens do not use the telephone at Christmas time. Serwold offered no reason why PRTA's current ratio could not have been easily improved to the required 1:1 or better by modest refinancing, switching some current debt to long-term debt PRTA's total debt was less than 45% of its assets (Ex. "T").

The Company's CPA was unable to explain why year-end accounts receivable were disproportionate to an average month's revenue but admitted that telephone companies "show a low profile" in their financial reports to the Utilities Commission (Tr. 0125-126).

Four months after Serwold and Coie relieved the Nelson family of its stock, PRTA met all conditions on payment of dividends; it borrowed long-term "for purpose of capital expansion" (cf. "Dividend Restriction", R. 362) $80,000 under terms requiring almost interest-only payments for twenty years (FF 22, R. 363). The loan, like the profit sharing plan, infra, was planned well before the fraud (Exs. "JJ" and "KK"; see "MM").

Coie's statement that "no dividends . . . can be anticipated for years" (Ex. "D") was not supported by any resolution of the Board of Directors to that effect

(AF 2.36, R. 280). Coie implied PRTA could not pay dividends while the truth was simply that the control group did not choose to do so. An annual dividend of $1 per share would have cost PRTA $7,123 per year (FF 7, R. 359). In February 1966, as a mark of its increasing affluence, and in contrast to Coie's despairing report to Korth (Ex. "D"), PRTA adopted a profit sharing plan to which it contributed in the years 1966-1971 $185,523.23.

That PRTA was "a regulated utility" (Ex. "D") did not preclude it from being highly profitable. PRTA's after-tax net income in 1965 was 14% of its operating revenues and this profit ratio rose to 20% in 1971 (Exs. "T" and "U").

The Non-Disclosures

Coie did not disclose the existence of the control group (AF 2.23, R. 274-5), nor, of course, that he was a

member thereof and stood to acquire a 10% beneficial interest in the stock he was soliciting (AF 2.23, R. 274-75), nor that Serwold was the chairman of the board and president of PRTA and its majority stockholder. Feigning an attorney relationship with PRTA (Ex. "B"), Coie masked his true capacity as Serwold's attorney. He did not disclose the intent of the control group to build up the company and sell it (FF 27, R. 365), nor that Serwold would soon in 1966 commence active solicitations respecting sale or merger of PRTA (FF 32 in Lanning v. Serwold, R. 346-47, 350, cf. Tr. 104-107, Ex. "HH").

Though Korth requested the "status" of the stock (Ex. "A"), Coie furnished no financial information, except to falsely imply by his offer that $5.00 per share was the fair value of the stock (Ex. "B"). When thirty months la-

ter Coie resumed his solicitation, he made no disclosure of PRTA's substantial progress during that hiatus, but instead submitted a despairing and misleading statement of PRTA's ability to pay dividends and a false statement respecting its surplus (Ex. "D").

During the Hiatus, in the years 1963 and 1964, PRTA added $12.15 per share to its "surplus" (retained earnings) and in 1965 was on its way to adding thereto a further $7.31 per share (AF 2.32, R. 278). From a year-end 1962 book value of $37.20 per share, such value climbed to $60.10 at year end 1965 and was destined to reach $164.42 at year-end 1971 (Id., R. 278-79; n. 1, supra).

In 1965 the company's operating revenues were 175% above its 1962 operating revenues, and its net profit was 227% above its 1962 performance (AF

2.31, R. 277-78). PRTA's retained earnings reached $420,951 in 1965, equivalent to $59.10 per share (AF 2.32, R. 278), 63% more than in 1962 when Coie first offered $5.00 per share (Ex. "B"). In 1965 prior to consumation of the securities transaction, PRTA added direct distance dialing and automatic ticketing to its plant facilities, installed a new submarine cable and was completing upgrade of its service to five parties or less on a line (AF 2.33, R. 279). Aside from its modernization, the company was blessed with steady growth (Id.) and had become, in early 1965, a marketable entity, in itself an explanation for Coie's abrupt resolicitation of the Nelson family's stock (Ex. "D"). Coie testified he didn't know what "triggered" him, after a lapse of 28 months, to write Exhibit "D" (Tr. 0043).

In January, 1972, PRTA sold substantially all of its assets, receiving stock of United Utilities, Inc., now called United Telecommunications, Inc. (United), traded NYSE, which PRTA exchanged 25 for 1 in redemption of its shares, a value of $500 for each PRTA share (Exs. FF, pp. 3, 13-14, A-9, GG).

ARGUMENT

Rule 10b-5 Liability

Coie's vicarious acts and omissions closely parallel the incident which 35 years ago caused, in a single day, Rule 10b-5 to be both drafted and promulgated. See Lanza v. Drexel & Co., 479 F.2d 1277, 1290 n. 32 (2nd Cir. 1973). The essence of the Rule, and one of the primary purposes of the entire 1934 Act, is to outlaw the use of inside information by corporate officers and principal stockholders for their own financial ad-

vantage to the detriment of uninformed public security holders (Id. p. 128990).

Though "scienter" is essential to the imposition of liability, that many-faceted concept broadly encompasses intent to deceive or defraud, knowing misstatement or omission of fact irrespective of intent, and reckless disregard for the truth (Id. p. 1289-90; Bucklo, The Supreme Court Attempts To Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder, 29 Stan. L. Rev. 213, 214 (1977)). As noted in the Opinion, 576 F.2d at 1337, "defendants' omissions were, at the very least, with knowledge," a more stringent standard of culpability than recklessness, with which defendants would have this Court deal and which, being on the less strict end of the scienter spectrum, was expressly reserved in Ernst & Ernst v. Hochfelder, 425 U.S. 185 at 193-94 n. 12, 47 L. Ed. 2d 668, 677 (1976).

In Ernst & Ernst, this Court stated the issue to be "whether scienter is a necessary element of a (10b-5) action, or whether negligent conduct alone is sufficient" (425 U.S. at 197)--a suggestion that the holding does no more than reject negligence. Deciding intent, expressly limited to the case (425 U.S. at 193-94, n. 12), and reserving recklessness, this Court apparently accepted a knowledge standard (Id. at 197). Indeed, at the close of the section on 10b-5 liability, Justice Powell concludes merely that: "We are quite unwilling to extend the scope of the statute to negligent conduct" (425 U.S. at 214). None of the cases or commentaries cited in the case as favoring a scienter requirement indicates that strict common-law intent to deceive is a necessary part of that requirement. The modern common law of fraud is that knowing mis-

statements, irrespective of intent, suffice for scienter. Even the English common law allows liability when the representation is "made (1) knowingly or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false." Derry v. Peek, 14 App. Cas. 337, 374 (1889). For excellent discussion of Ernst & Ernst, see Bucklo, supra, 29 Stan. L. Rev. 213 (1977), and McLean v. Alexander, 420 F.Supp. 1057, 1080 (D. Del. 1976). There appears to be no case rejecting knowledge or recklessness as a sufficient 10b-5 culpability.

The Degree of Defendants' Culpability

Coie's affirmative misrepresentations and nondisclosures betray his state of mind. At the outset, seeking Korth's confidence, Coie feigned a corporate reply (Ex. "B" and "B-1"), knowing Korth would reasonably accept it as

such, which he did (Korth Dep., p. 11). So disguised, defendants and Coie acted as predators, taking gratuitous advantage of Korth's inquiry as to "the status of the stock" (Ex. "A") to solicit purchase of the same for a ridiculously low price--$5.00 per share" (Ex. "B"), knowing Korth and the Nelson family were geographically disadvantaged, and, like most other minority stockholders, had utterly no information upon which to base an investment decision respecting PRTA stock (AF 2.23-2.27, R. 268, 274-76).

The disparity of information and of access to information which existed between Serwold and Nilsson, or between Coie and Korth, could not conceivably be greater in any 10b-5 case. The compelling implication is that defendants and Coie well knew the inherent unfairness involved in the transaction, because

they were taking advantage of a plethora of corporate information, including that held to have been material to the transaction, knowing it was unavailable to Nilsson and Korth. So, too, the unjustified low price creates under the circumstances a rational inference that defendants and Coie knew they were taking undue advantage in the transaction.

Disclosure to a seller of stock that his purchaser is the president and the majority stockholder of the issuer corporation is apt to trigger inquiry, especially if the purchaser initiated the transaction. The same is true as respects disclosure that an attorney, who answers for, and is erroneously believed to represent, the corporation, actually represents a secret control group, of which he is a member, and which is the real purchaser. Conversely, nondisclosure of such relationships,

especially by insider purchasers, implies recognition of the adverse consequence of disclosure and tends to show a knowing or reckless, if not a studied and intentional, omission.

The district judge felt there was no special relationship between Coie and Korth; that they "were simply two lawyers--carrying on what was apparently a routine and rather minimal transaction." (DC Opinion, R. 309 at 311.) Man's naivety is boundless. The special relationship was, of course, that of agent for, and co-principal of, fully-informed corporate insiders[3], vis-a-vis the representative of an utterly uninformed minority stockholder. The rela-

[3]Mrs. Serwold was at all times a director of PRTA (FF9, R. 360).

tionship was fiduciary--that of majority stockholder, president and chairman of the board to minority stockholder. Defendants' duty was not less because they chose to deal through their personal attorney, Coie, who also was an insider and who "stood to acquire, and did acquire, a 10% beneficial interest in the stock." (AF 2.23, R. 274-75.) Plunkett v. Dominick & Dominick, Inc., 414 F. Supp. 885 (D.C. Conn. 1976); Lanza v. Drexel & Co., 479 F.2d 1277, 1293 (2d Cir. 1973). Coie's failure to disclose the identity of his principal and the relationship of the latter to PRTA, as well his failure to disclose the existence of the control group, its members and its plan to build up and sell the company, was either intentional or knowing, defendants and Coie testifying to no inadvertency about these matters. Defendants' initiative in the transac-

tion and Coie's final triumphant statement to Serwold, "at long last I think we have acquired Norman's (plaintiff's) shares" (Ex. "M"), also show that their misrepresentations and nondisclosures were not merely inadvertent without any fraudulent or deceitful intent, but were studied and intentional, to be characterized as a scheme to obtain the stock without giving any information whatsoever as to the true condition of the company or the value of its stock, so as to, in that way, obtain the same at an extreme low price.

Indeed, far from inadvertency, Coie's testimony disclosed a flippant, rather arrogant state of mind:

> Q. Did you search diligently the records of the company before you wrote the letter (Ex. D)?
>
> A. No, I did not. In fact, I didn't search them at all. (Tr. 0045.) [His access to corporate information was carte blanche (Tr. 0055 & 0056).]
>
> . . .

> Q. Why did you not send a financial statement to Mr. Korth?
>
> A. He didn't ask me for one. (Tr. 0054.)
>
> . . .
>
> Q. And you didn't feel, I take it, that you had any obligation to Mr. Korth to investigate those matters or to disclose them to him?
>
> A. Perfect stranger to me. A lawyer is all I knew. (Tr. 0057.)

So, Coie, an able, senior attorney, a writer of proxy statements (Tr. 0051-52, 0056), denied even at the trial defendants' and his own duty of disclosure. If Coie was unfamiliar with the Insider Rule, ingrained in 10b-5 law well before 1962, he did not say so, and if he was, an intentional violation of the rule must be presumed. The district court held:

> This combination (of undisclosed material facts) ought to have made Coie, as a capable and experienced lawyer, aware that Korth must have been relying to rather considerable

> extent on the relationship between himself and Coie in making an investment decision, and in disclosing those things which a seller would be likely to want to know. (DC Opinion, R. 309, 313, incorporated as a finding, FF p. 2, R. 358).

As noted in the Court of Appeals Opinion, 576 F.2d at 1335, Korth expressly indicated to Coie his assumption that the original $180 price was "the value of the stock," stating a second time in the same first paragraph of his letter, "We (Korth) assume it represents the fair market value of the stock." (Ex. "E", letter, Korth to Nilsson, cc: Coie, 4/20/65.) Coie made no disclaimer; he knowingly chose silence, an implicit confirmation of his own suggested value. Coie's refusal to dispel the false notion of value could only be intentional, knowing or reckless.

Coie's gratuitous, false statement to Korth that "there has never been a

surplus from which dividends could have been declared" (Ex. "D") was devastating. Not only was the statement false, but also it falsely implied the company, throughout its 57-year history (FF 5, R. 359) had never been profitable. Naturally, the letter falsely indicated to Korth that PRTA was probably in "quite precarious" financial condition (Korth Dep., p. 49).

Even a statement which is literally true, if reasonably susceptible to quite another interpretation, may properly be considered a material misrepresentation. SEC v. First American Bank & T. Co., 481 F.2d 673, 678 (8th Cir. 1973). A statement may be found misleading in view of the context in which it was made (Id.). It is the impression created by the statements which determines whether they are misleading. Kubik v. Goldfield, 479 F.2d 472, 476, n. 7, (3rd Cir. 1973).

Coie was at least reckless, admitting, in preparing the letter (Ex. "D"), he made no search at all of company records (Tr. 0045). But the letter was more; it was deceptive, cunning and manipulative. Making no mention of PRTA's startling progess during the previous 28 months since his initial and last letter (Ex. "B"), nor since then of the 62% increase in the book value of PRTA's shares, Coie addressed Korth as if no increase in value of the stock had occurred, purveying only despair under a ruse of answering Korth's 27-month-old inquiry whether any dividends were accrued (Ex. "C"). Coie's reference to the company being "a regulated utility" could have been, in context, only intended to impart a notion that the company was permitted only sparing profits, when in truth the company was making excellent profits, measured either as a

percentage of its revenues or return on equity (FF 24, R. 363-64, Ex. "T"). Indeed, in 1971, PRTA earned, and was permitted to earn, a net profit equal to 20% of its operating revenues (Ex. "U"). Serwold received a copy of Coie's letter (Ex. "D", FF 13, R. 360) and must have recognized its inaccuracies and deceptive innuendo.

All of the essential facts are agreed. Defendants have no ground for charging the Ninth Circuit with "usurpation" (Pet., p. 26) because that court concludes, from the findings and/or the agreed facts, "that the defendants' omissions were, at the very least, with knowledge" or, alternatively, were reckless or encompassed "some degree of intent not sufficiently aggravated to be characterized as 'deliberate and cold blooded'"--the district judge's definition of "scienter."

Materiality

As a matter of law, a reasonable man, in making his investment decision, "would attach importance" to a plan to sell the company in which he held stock and for which there was little or no market. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 48 L. Ed. 2d 757 (1976). The control group plan to build up and sell the company may have been "long range" in 1956, but it was not in 1965. By then the build up had largely occurred (AF 2.33, R. 279). Soon in 1966 Serwold was to commence active solicitations respecting sale or merger of PRTA. The timing of his solicitations was resolved adversely to defendants on remand in the earlier case of Lanning v. Serwold, supra, and may not be relitigated. Harris v. Washington, 404 U.S. 55, 56, 30 L. Ed. 2d 212, 215 (1971); Adelt v. Richmond School

District, 476 F.2d 662 (9th Cir. 1973). Equally material would be "the steady and significant increases in earnings and book value in the few years between the opening inquiry and the sale" (DC Opinion, R. 313, adopted as a finding, FF p. 2, R. 358), particularly if the seller were utterly uninformed as to the financial condition and operations of the company, and in the first instance had been misinformed by a trusted source as to the value of the stock.

The District Court's Findings

The district judge's definition of "scienter" was to "deliberately and cold-bloodedly set out to conceal information which 10b-5 requires to be provided" (FF 28, R. 366, DC Opinion, R. 314), a categorical, though somewhat ingenuous, embracement of the most strict common-law definition, i.e. intent to deceive. So defining "scienter," the

district judge said the evidence did not indicate defendants' 10b-5 omissions "occurred knowingly in the 'scienter' sense" (DC Opinion, R. 314), meaning the omissions were not "knowing" in the sense of being "deliberate and cold-blooded." The district judge tied knowledge to the strictest culpability, rather than recognizing knowledge as being in itself the keystone of a less culpable, alternate definition of "scienter." Rejecting "scienter," the district judge did not discuss or analyze its multiple facets, and made no finding of ultimate fact respecting any degree of culpability less stringent than intent to deceive, or as he put it, "deliberate and wilful (cold-blooded) fraud" (R. 352).

The district judge's recital of reliance "to a considerable extent upon observation and demeanor and manner of

the witnesses when they testified" (FF 28, R. 366[4]; also R. 309, 314) is ill-considered. There was no demeanor testimony. There exists not conflicting or ambiguous testimony; a credibility choice is not present. Neither Serwold nor Coie testified as to his intent, a circumstance oddly compelled by the District Court very early in the trial during the examination of Serwold, the first witness:

> Q. Had the company entered into a contract by which it undertook to make capital improvements?
>
> THE COURT: Mr. Cameron, . . . as far as I am concerned, if these documents (exhibits) create liability, they create liability. If they don't, they don't. I am not the least bit interested in what this gentleman thinks he meant or Mr. Coie meant when they said (i.e. wrote) certain things back in

[4]Defense counsel's contention that Judge Burns "himself" (Pet. p. 12) prepared finding 28 is false. It is, verbatim, defendants' proposed finding No. 30 (Ex. 7, p. 8).

> 1965. . . . and I have extended myself in this case just as far as I am going to. I am interested in trying this lawsuit on the merits. And I am not the least bit interested in what this gentleman thinks Mr. Coie may have thought in 1965. What he said in 1965 or didn't say is what is important. Now, I hope you can proceed ahead with your questioning of this witness in light of that statement.
>
> MR. CAMERON: Yes, Your Honor. I stand chastized. . . .
>
> THE COURT: Mr. Korth's deposition was taken and you spent a great deal of time asking Mr. Korth what he understood and what he thought and what he meant. It doesn't make a bit of different to me. What is important is what was said and what was not said. . . . That is what I am interested in, because that is what depends on how this lawsuit is decided. Please proceed. . . .

(Tr. 0024-25.)

Thusly, and in a harshly-toned stricture, the district judge foreclosed inquiry into Serwold's and Coie's state of mind, viz: what either thought or meant by their actions. Having done so

and having declared his intention to decide the case on the documentary evidence, the district judge's self-supportive statement of his reliance "to a considerable extent upon observation and demeanor and manner of the witnesses when they testified," calls for no more weight than its pretentiousness suggests.

The Ninth Circuit's Conclusions

In addition to intent, the Ninth Circuit accepted a knowledge standard and also, alternatively, "recklessness, or some degree of intent not sufficiently aggravated to be characterized as 'deliberate and cold-blooded'." (576 F.2d at 1337-38.) It concluded the defendants' omissions "were, at the very least, with knowledge" (p. 1337) and that the evidence also supported application of the alternate standards (p. 1338). The district judge did not make

a finding of ultimate fact concerning any of these less strict meanings of scienter--meanings which he did not accept.

The absence of a finding of ultimate fact does not require reversal of the judgment if the circumstantial facts as found are such that the ultimate fact follows from them as a necessary inference. Confederated Bands of Ute Indians v. United States, 330 U.S. 169, 177 n. 3, 91 L. Ed. 823, 828 (1947). Conversely, ultimate facts, like conclusions of law, are subject to review free of the restraining impact of the so-called "clearly erroneous rule." Galena Oaks Corporation v. Scofield, 218 F.2d 217, 219 (5th Cir. 1954). The district judge's conclusion of law that there was a "lack of scienter" (R. 366) is not subject to the rule. 5A Moore's Federal Practice, 2d ed., § 52.03(2), p. 2662.

Findings of fact that are induced by or combine an erroneous view of the law are not binding. (Id. § 5203(3), p. 2664).

The district judge was not specific as to all the circumstantial omissions found. His findings state:

> Within the meaning of Rule 10b-5 and its state counterpart, I find that omission liability exists considering the various omissions in their entirety but particularly concentrated on . . . two central areas . . . .

(FF 27, R. 365, emphasis supplied.)

The 45 admitted facts (R. 269-81), including exhibits "A" through "N" and "FF-1," "GG-1" and "GGG-2" which "reflect the entirety of the transaction" (AF 2.12, R.270, FF 13, R. 360), and which were admitted in evidence, compel the ultimate fact of 10b-5 fraud, at least under any standard of culpability less than what the district judge characterized as "deliberate and cold-blooded." The "found" facts, of which

the district judge took particular notice (i.e., failure of corporate, insider purchasers of small, independent telephone company stock to disclose to an uninformed seller the existence, and the relationship to the insiders, of a control group and its intent to acquire a majority of the shares, build up the company and to sell it), compel the same ultimate fact conclusion, and all the more so when active solicitations for sale or merger of the company were to commence the very next year (R. 346-47, 350, Tr. 0104-5). See Monsen v. Consol. Dressed Beef Co., Inc., 579 F.2d 793, 803 n. 17, 804 (3rd Cir. 1978).

Additional "found" facts contained in the district judge's Opinion (R. 309) and adopted as findings (FF p. 2, R. 358) also compel an ultimate fact conclusion of 10b-5 fraud, viz., the undisclosed specified increases in earnings

per share and in book value per share during the 1962-65 hiatus in correspondence, as compared to the initial offer of $5.00 per share, of which the District Judge said:

> In short, I conclude that the evidence preponderates on this issue in Plaintiff's favor, and hence, that omission liability under 10b-5 exists (R. 311, cf. R. 312, line 32, -- R. 313, lines 1-13, and see the district judge's curious footnote to his Opinion concluding, even aside from the Insider Rule, which he seemed incapable of fitting within his analysis, 10b-5 "omission liability" established "as a matter of fact and law."

(R. 315).

Oddly, in addition to "usurpation" (Petition p. 26), defendants charge the Ninth Circuit with having violated F.R.C.P. Rule 52(a), though its Opinion is consistent with the District Court's findings, and the rule is but a limitation upon making findings inconsistent with the latter. There is gross deceit in these charges. When defendants say the district judge "explicitly found"

that the nondisclosure did not occur "knowingly in the 'scienter' sense" (Pet. p. 23), they do not state the context in which the statement was made; that the district judge was not alluding to a less strict knowledge culpability, but meant that the omissions were not knowing in the sense of being "deliberate and cold-blooded". The defendants also emphasize the ill-considered recital in the findings that the district court relied upon his "observation of the demeanor and manner of the witnesses when they testified." There exists neither conflicting nor ambiguous testimony; a credibility choice is not present; and the logic of the recital is inappropriate to the district judge's stricture at the commencement of the trial against plaintiff inquiring as to defendants' or Coie's state of mind at the time of the fraud (supra, p. 45).

Appellate courts are free to draw inferences and conclusions from admitted facts and findings and are in as good a position to weigh deposition and documentary evidence as is the trial judge. Gillette's Estate v. C.I.R., 182 F.2d 1010, 1014-15 (9th Cir. 1950), reversing a state-of-mind determination, stating the Circuit Court is "as well equipped to draw inferences as is the Tax Court, and for that reason the Tax Court decision calls for little more weight than its logic suggests." See also Western Union Telegraph Co. v. Bromberg, 143 F.2d 288, 290 (9th Cir. 1944). Although the Ninth Circuit did not overturn any finding of fact, it is said that the burden of showing a finding of fact "clearly erroneous" is "much lighter" when the facts are undisputed or the evidence is documentary. Galena Oaks Corporation v. Scofield, 218 F.2d 217, 219 (5th Cir. 1954).

The Damages Issue

The district judge refused to believe that this Court actually meant what it said when, in an opinion by Mr. Justice Blackmun, it clearly, and unequivocally, stated the measure of 10b-5 damages for defrauded sellers, viz: ". . . where the defendant received more than the seller's actual loss, (the) damages are the amount of the defendant's profit." Affiliated Ute Citizen v. United States, 406 U.S. 128, 155, 31 L. Ed. 2d 741, 762 (1972). As stated in the seminal 10b-5 disgorgement-of-profits case, Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965): "It is simple equity that a wrongdoer should disgorge his fraudulent enrichment."[5]

[5]Accord: SEC v. Shapiro, 494 F.2d 1301, 1309 (2d Cir. 1974), Zeller v. Bogue Electric Mfg. Corp., 476 F.2d 795, 801-802 (2d Cir. 1973), Rochez Bros., Inc. v. Rhodes, 491 F.2d 402, 411-412 (3rd Cir. 1974), Baumel v. Rosen,

That the defrauded seller's damages may exceed his actual loss rests not alone on the disgorgement principle, but also, quite independently, upon the doctrine of "rescissional damages" originating, at least in 10b-5 law, with Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951, 19 L. Ed. 2d 1143, (1968). There, a problem arose as to how rescission could be determined by a jury when that remedy is

[5](cont.)412 F.2d 571, 575-576 (4th Cir. 1969), Ohio Drill & Tool Co. v. Johnson, 498 F.2d 186, 190-191 (6th Cir. 1974), Chasins v. Smith, Barney & Co., 306 F. Supp. 177, 178 (S.D.N.Y. 1969). The disgorgement principle is not peculiar to 10b-5 violations resulting in unjust enrichment. See, for example, Clark v. Bunker, 453 F.2d 1006, 1011 (9th Cir. 1972), applying the principle to misappropriation and use of a trade secret. In Schur v. Salzman, 365 F. Supp. 725, 735 (D.C.N.Y. 1973), dealing with another section of the Act, the court said: "The courts have been consistent in the view that the most effective way to enforce section 16(b) [15 USC § 78p(b) creating insider liability for short swing profits] is a rigid rule taking all the profits out of any transaction which comes within its proscription."

available solely in an equitable action.

Judge Lay held:

> But in an action at law a jury may award rescissional damages if the contract has already been mutually rescinded or is otherwise set aside by law. (Citations omitted). Here, neither the jury nor the court was required to rescind the agreement; Section 29(b) of the statute itself declares the sale void, once there is found a violation of Rule 10b-5. 15 U.S.C. § 78cc(b); . . . If the contract was void as a matter of law, the plaintiff was entitled to restitution of what he sold, or, since restoration of the stock was here impossible, an equivalent money judgment.

(pp. 741-742.)[6]

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[6]Restitution does not depend upon the existence of the element of intent to deceive but is available against even the innocent wrongdoer. Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. 66, 101 (D.C.N.Y. 1969), aff'd., 478 F.2d 1281 (2d Cir. 1973). A Federal Court may use any available remedy to make good the wrong done and, according to the exigencies of the particular case, may fashion a remedy to rescind a fra udulent sale, to secure restitution and even to enforce the right to restitution against a third party holding a defrauded seller's assets. J. I. Case Co. v. Borak, 377 U.S. 426, 433, 12 L. Ed. 2d 423, 428 (1964).

Here, the District Court strayed into and accepted the clearly erroneous argument made by defendants in Myzel, the contention being that damages for less than "deliberate and cold-blooded" nondisclosure do not extend to accretional value but only to "out-of-pocket" losses. Judge Lay put the matter to re st, holding:

> But there exists no apparent reason to apply different rules of damage to different violations under the Act. The act of nondisclosure is the evil proscribed, not the motive that induced it.

Myzel, supra, pp. 747-748.

Three years later this Court ruled similarly as Judge Lay, holding in Mills v. Electric Auto-Lite Co., 396 U.S. 375, 386-387, 24 L. Ed. 2d 593, 603-604 (1970), involving violation of § 14(a) of the Act (misleading proxy statement) that § 29(b) of the Act [15 USC § 78cc(b)] renders the sale void "at the

option of the innocent party . . . giving him the right to rescind", stating preparatory thereto that the specific unlawful activity committed "implies nothing about the form of relief to which they (plaintiffs) may be entitled", and "that upon finding a violation the courts (are) to be alert to provide such remedies as are necessary to make effective the congressional purpose".

Aside from either the disgorgement principle or the rescissional damages doctrine, the special facts of this case, partially noted in the Opinion, 576 F.2d at 1339, n. 5, compel a conclusion that but for the fraud, plaintiff would have realized in January, 1972, 25 shares of United (a value of $500) for each PRTA share. Under these circumstances, plaintiff is entitled to be put in substantially the position in which

he would have been but for the fraudulent deprivation of his stock. Restatement of Restitution, § 151, comment c (1937).

The district judge viewed rescissory damages as the "equivalent" of restitution, deemed either an "exceptional remedy" and rejected each as "an inappropriate remedy" because "the fraud involved" was not "relatively severe" but involved only omissions (R. 351, incorporated as Conclusions, R. 358-59). He took no heed of the special facts partially noted in the Opinion, 576 F.2d at 1339 n. 5, showing, but for the fraud, plaintiff would have realized defendants' gain. Rejecting the appropriate measure of damages, he fashioned a minimal out-of-pocket recovery which failed to give any recognition to the actual or intrinsic value of the stock, as measured either by the going-concern value of

the Company or by the true value of its net assets, nor as measured by the non-disclosed intent of the control group to sell the Company, the very nondisclosure upon which the court found liability.[7]

To support the stingy award, the district judge cited "defendants' (post-sale) efforts contributing to the growth and increase in value of PRTA" (R. 352). However, there exists not one quark of evidence of such efforts. Even the contention thereof originates with the district judge and was not advanced at trial. The admitted fact is that prior to the securities transaction, the Com-

[7]The district judge said he was "impressed" by, and largely "accepted (the) opinion" (R. 354) of, defendants' surprise, "expert" witness who testified post-trial to his examination of a far-off, unrelated telephone company, and whose testimony was taken without fair notice to plaintiff in violation of the district judge's own counsel letter (R. 351, 353) and of plaintiff's rights under F.R.C.P. 26(b)(4)A. Plaintiff's timely objections (Tr. 0148-49) were overruled (Id.). The Ninth Circuit apparently treated as moot plaintiff's assignment of error on the matter.

pany's "build up" had largely occurred and it was experiencing "steady growth" (AF 2.33, R. 279).

The district judge concluded that plaintiff's damages should be calculated on the basis of the fair market value of the stock as of December 31, 1967, for the reason that this value represents the highest value reached by the stock within a reasonable time after the sale thereof. (Conclusion of Law 1, R. 366-367). Anomalously, that conclusion would fix the damages even before the statute of limitations commenced, which was when plaintiff discovered the fraud or could have done so in the exercise of reasonable diligence. Hilton v. Mumaw, 522 F.2d 588, 601-602 (9th Cir. 1975). The district judge's conclusion assumes the fraud terminated at or about the time of the sale, when in fact defendants owed to plaintiff a continuing

duty of disclosure to the time of the latter's actual or constructive discovery of the fraud. Defendants' fraud continued to the date of sale to United (Tr. 0091-92).

The gist of the district judge's ruling is that if a wrongdoer can escape detection "for a reasonable time" after his fraud (in his opinion, not more than 27.5 months), he is home free and may keep all profits or enrichment which thereafter accrue. Such a result rewards concealment, fails to effectuate the congressional purpose of the Act (i.e., protect investors, including deterrence of insider fraud), is unfair to the victim, and is, of course, contrary to law. The correct time frame for ascertaining the value of the stock for the purpose of measuring damages is the time of discovery of the fraud. In Gerstle v. Gamble-Skogmo, Inc., 478 F.2d

1281, 1306 n. 27 (2d Cir. 1973), Chief Judge Friendly stated:

> Section 151, comment c, of the Restatement of Restitution, cited both in Janigan and in Myzel . . . limits recovery to "the highest value reached by the subject matter within a reasonable time after the tortious conduct". If the fraud is such that it could not reasonably be discovered until a later date, the rule is that recovery is limited to the highest value reached within a reasonable time after that date. See, e.g., Baumel v. Rosen, supra, 412 F.2d at 576. . . .

That measure which is the highest value reached within a reasonable time after the fraud is not a limitation on damages, but actually is an alternative which may be invoked by the plaintiff. Baumel v. Rosen, 412 F.2d 571, 574 (4th Cir. 1969). Myzel v. Fields, 386 F.2d 718, 746 (8th Cir. 1967) states:

> Actually, damage for tortious conversion by deceit provides a comparable legal remedy. (Citations omitted). The federal courts have historically approved a rule of damages for conversion of stock measured by the price at the time of conversion or the highest inter-

> mediate value reached within a reasonable time after notice of the conversion by the plaintiff, whichever is greater.

(Emphasis supplied; see also p. 746 n. 25).

The Tenth Circuit fixes 10b-5 damages, even in defrauded buyer cases, as of the date of discovery (or notice) of the fraud. Richardson v. MacArthur, 451 F.2d 35, 43-44 (10th Cir. 1971). The discovery rule is particularly appropriate when, as here, the actual value of the stock cannot be determined until discovery of the fraud. See, Esplin v. Hirschi, 402 F.2d 94, 104-105 (10th Cir. 1968), Loss, Securities Regulation 1630 and 1793 (2d Ed. 1961); Restatement of Torts, § 549, comment c (1938).

Much as an afterthought, the district judge opined that "Plaintiff could have discovered the inaccuracies of this transaction. . . by asking for additional financial information" (R. 352). If

none of the other 150 PRTA shareholders, or even the Washington Utilities & Transportation Commission (which took annual affidavits on the subject), ever discovered the existence of the control group, which is the admitted fact (AF 2.23, R. 274-75), it is odd the district judge should believe defendants would ever have revealed their secret to plaintiff. Indeed, it is naive to think that defendants would have given plaintiff, upon request, any "additional financial information" (as if any, except for the $5.00 offer, had been given). PRTA admittedly did not give out financial statements or other reports and held no meetings of shareholders. (AF 2.24-2.26, R. 275-76). Also, of course, it was defendants' duty to disclose, not plaintiff's duty to inquire.

Quoting Blackie v. Barrack, 524 F.2d 891, 908 (9th Cir. 1975), defense

counsel contends the District Court, not plaintiff, is entitled to choose the remedy. His quotation from the case is wrenched from context of a class action involving potential conflicting interests of class members in proving damages and the sufficiency of such conflicts to defeat class action status. Surely, in such a case, it is for the district judge to promptly decide, preliminarily ("in the first instance" p. 909), which of the requested remedies is appropriate. In Blackie, the alleged conflicts depended entirely on adoption of the out-of-pocket loss measure of damages and were avoided on adoption of the rescissory measure. 524 F.2d at 908. Also, Blackie is a defrauded purchaser case requiring a damages choice between either a price-value differential or between the price paid and a later price received. See, Chasins v. Smith, Barney

& Co., 438 F.2d 1167, 1173 (2d Cir. 1970). Here, there is only one correct measure of damages--the rescissory/disgorgement measure. Affiliated Ute Citizens v. United States, 406 U.S. 128, 155, 31 L. Ed. 2d 741, 762 (1972).

From the beginning plaintiff has sought, exclusively, either restitution in the form of an equivalency award of United Telephone stock and dividends or rescissory damages. (Complaint, R. 1, 6-7.) Just as a defrauded buyer may "choose" rescission, instead of the difference between the value of what he gave up and the value of what he received, a defrauded seller is entitled "to choose" the rescissory measure of damages. Abrahamson v. Fleschner, 392 F. Supp. 740, at 746 (S.D.N.Y. 1975). The nature of the relief sought, not the statute which creates the right, determines the legal or equitable remedy.

Myzel v. Fields, 386 F.2d 718, 741 (8th Cir. 1967), Straley v. Universal Uranium & Milling Corp., 289 F.2d 370, 373 (9th Cir. 1961).

Defense counsel suggests requiring return of ill-gotten gains is "too draconian," citing Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1304-1306 (2d Cir. 1973). There, the Second Circuit refused to require the defendants to account for unrealized appreciation, when the fraud related only to realized gain, but approved an award to plaintiff of the profits realized by defendants. However, the court said:

> We would agree that the Janigan principle is not confined to situations where the purchaser resells within a short time, and that in a proper case a court could award a plaintiff the unrealized appreciation of securities obtained through fraud. . . .

(p. 1305.)

Federal Issues Superseded

Issue: Will the Securities Act Amendment, RCW 21.20.430(2) (1975), amended 1977, be applied retroactively to lawsuits alleging violation of RCW 21.20.010 (1959) filed prior to the effective dates of the amendment, viz: September 8, 1975, and September 21, 1977? Plaintiff contends "yes!"

The Washington counterpart of Rule 10b-5, RCW 21.20.010 ("Section 10") has remained unchanged since its enactment in 1959. Aping 10b-5 history, a private cause of action for damages was implied from Section 10 in an insider, purchaser's fraud case, Shermer v. Baker, 2 Wn.App. 845, 472 P.2d 589 (1970). At that time the civil liabilities section of the Securities Act (RCW 21.20) expressly created a damages cause of action only in favor of a defrauded purchaser against: "Any person, who . . .

sells a security by means of fraud or misrepresentation . . ." RCW 21.20.430(1) (1959), emphasis supplied. In 1975 the legislature added to the Securities Act subsection .430(2) creating a damages cause of action against: "Any person who buys a security by means of fraud or misrepresentation. . ." RCW 21.20.430(2) (1975), emphasis supplied.

There followed Ludwig v. Mutual Real Estate Investors, 18 Wn.App. 33, 567 P.2d 658 (1977), a seller's fraud case. Focusing on the statutory words "by means of fraud or misrepresentation," and failing to discuss negligent misrepresentation long recognized in Washington, the state court of appeals adopted the federal scienter requirement, and, noting the aforesaid "erstwhile statutory omission has since been remedied," 18 Wn.App. at p.42, opined

that a private cause of action for damages should not be implied from RCW 21.20.010, in all respects overruling, sub silentio, the Shermer case.

The legislative reaction was swift. The legislature neatly cut out of the Securities Act "by means of fraud or misrepresentation," substituting therefor "in violation of the provisions of RCW 21.20.010." RCW 21.20.430(1) and (2) (1977). The latter amendment now reads:

> (2) Any person who buys a security in violation of the provisions of RCW 21.20.010 is liable to the person selling the security to him, who may sue either at law or in equity to recover the security, together with any income received on the security, upon tender of the consideration received, costs, and reasonable attorneys' fees, or if the security cannot be recovered, for damages. Damages are the value of the security when the buyer disposed of it, and any income received on the security, less the consideration received for the security, plus interest at eight percent per annum from the date of disposition, costs, and reasonable attorneys' fees.

The tender, a 1977 innovation, may be made at any time before entry of judgment. RCW 21.20.430(6) (1977).

The substantive anti-fraud provisions of the Securities Act, RCW 21.20 .010--the Washington counterpart of Rule 10b-5--became effective June 10, 1959, years before the fraud involved in this case. In addition to administrative (RCW 21.20.110 and 280), injunctive (RCW 21.20.390), and criminal (RCW 21.20.400) remedies, a statutory damages action in favor of defrauded purchasers, and, at the time of the judgment herein and until 1977, an implied damages action in favor of defrauded purchasers and sellers, has always lain for violation of RCW 21.20.010. RCW 21.20.430(2) became effective subsequent to the fraud herein involved and the commencement of this suit. Neither that provision nor any

other amendment contains any language expressing the legislative intent with respect to the question of retrospective or prospective operation of RCW 21.20.430(2). The question has not been before the Washington appellate courts.

Though a statute ordinarily operates prospectively, it will be applied retrospectively if it is remedial. Tellier v. Edwards, 56 Wn.2d 652, 354 P.2d 925 (1960). A statute is remedial and has retroactive application when it relates to practice, procedure or remedies and does not affect a substantive or vested right. Ibid, p. 653; Nelson v. Dept. of Labor & Industries, 9 Wn.2d 621, 115 P.2d 1014 (1941).

Though the question is one of legislative intent, it is not necessary that the statute expressly state that it shall operate retrospectively. Pape v. Dept. of Labor & Industries, 43 Wn.2d

736, 741, 264 P.2d 241 (1953). In Pape at p. 741, the Washington Supreme Court said:

> In the absence of language showing a contrary intent, a new law changing a remedy is generally regarded as applicable to all remedies--those which have accrued and those which will accrue in the future.

The presumption favoring prospective application is actually reversed if the statute is remedial and its remedial purpose is furthered by retroactive application. Haddenham v. State of Washington, 87 Wn.2d 145, 550 P.2d 9 (1976). In that case the reverse presumption of retrospectivity was applied to the state crime victims compensation act, (RCW 7.68), which abolished all actions against the state for injury or death as a consequence of a criminal act and incorporated for crime victims the workmen's compensation benefit schedule. In 1977, the legislature repealed RCW 7.68.040, the abolition-of-civil-actions

provision. Holding the amendment remedial in purpose, the Washington Supreme Court held the amendment applied retroactively. Holt v. Moses Lake, 89 Wn.2d 376, 572 P.2d 1100 (1977).

In Lau v. Nelson, 89 Wn.2d 772, 575 P.2d 719 (1978), the Washington Supreme Court held that repealing acts terminate all rights dependent upon the repealed statute and thus operate retroactively. Hence, a 1974 law repealing the Washington host-guest statute (RCW 46.08.080) was applied retroactively.

In Godfrey v. State of Washington, 84 Wn.2d 959, 530 P.2d 630 (1975), the Washington Supreme Court unanimously ruled that the state's 1974 comparative negligence statute applies to every cause of action for which judgment is entered subsequent to the effective date of the statute, regardless of when the action arose. The reasoning of the

court was that the defense of contributory negligence is not a substantive right but a procedural matter. As a measure of the relative ease in which retrospectivity is presumed in Washington, as compared to other states, at least five other states have been faced with the same question of retrospectivity raised in Godfrey, yet the courts of all five decided the comparative negligence statute should be applied only prospectively.[8]

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[8] Reddell v. Norton, 225 Ark. 643, 285 S.W.2d 328 (1955); Moore v. Fenton, 289 A.2d 698 (Me. 1972); Fuller v. Illinois Cent. R.R., 100 Miss. 705, 56 So. 783 (1911); Joseph v. Lowery, 261 Ore. 545, 495 P.2d 273 (1972); Holzem v. Mueller, 54 Wis.2d 388, 195 N.W.2d 635 (1972) (as to an amendment to the statute); Brewster v. Ludtke, 211 Wis. 344, 247 N.W. 449 (1933).

The cogent and persuasive reason supporting the Godfrey decision was the practical problems a dual system of recovery would create for litigants and the courts. The Godfrey court said:

> It would be incongruous indeed to frustrate this obvious legislative change in policy by adopting a position that would permit the rejected bar to recovery (contributory negligence) to continue in operation for years to come. Yet, such would be the result if we were to hold the operation of RCW 4.22.010 and .020 (comparative negligence statutes) to be prospective only.

84 Wn.2d at 967, 530 P.2d at 634.

RCW 21.20.430(2) is remedial in purpose and therefore applies retroactively. Created by a 1975 amendatory act, its purpose is to provide a statutory civil damage remedy against purchasers of a security who violate Section 10 of the Securities Act, precisely as was previously implied in the Shermer decision. The amendment corrected a legislative oversight in creating a remedy for a purchaser but not a seller.

The 1977 amendment further focuses on remedy, eliminating strict proof of fraud, creating a return to Shermer v. Baker, 2 Wn.App. 845, 472 P.2d 589 (1970), and redefining damages. It is unlikely that a Washington court would construe RCW 21.20.430(2) not to operate retrospectively and thereby accept a dual system of recovery rejected in the Godfrey decision. Obviously, the remedial statute renders moot the federal issues in this case.

CONCLUSION

The Ninth Circuit has sustained the District Court's findings relating to defendants' liability and, consistent therewith, has properly drawn inferences and conclusions from those findings, inferring the ultimate fact "that the defendants' omissions were, at the very least, with knowledge." 576 F.2d at

1337. The parties' stipulation of virtually all the evidence, reduced to forty-five agreed facts plus designated documents reflecting the entirety of the transaction, expands the scope of judicial review and placed the Ninth Circuit in as good a position as the District Court to weight such evidence and draw inferences therefrom, and especially so, since this case was not decided upon the basis of a credibility choice and the District Court was not burdened with resolution of conflicting or ambiguous testimony. Appellate courts are free to overturn erroneous conclusions of law, and the Ninth Circuit has done so both in respect to clarification of the District Court's conclusion referring to "the lack of scienter" (by which it meant "lack of intent to deceive") and its erroneous rejection of the correct measure of damages. In addition, the

Federal issues have been rendered moot (superseded) by the retroactive amendment of the Washington Securities Act and the attendant ascendancy of the adjudicated violation of RCW 21.20.010.

Defendants' Petition For Writ of Certiorari should be denied.

Respectfully submitted,

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